

**Letter of Findings: 08-0589
Indiana Corporate Income Tax
For the Tax Years 2004-2005**

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ISSUE

I. Adjusted Gross Income Tax—Imposition.

Authority: IC § 6-3-1-3.5; IC § 6-3-2-2; IC § 6-3-2-2.8; IC § 6-8.1-5-1; IC § 27-1-18-2; [45 IAC 3.1-1-62](#); I.R.C. § 1504; Cooper Industries v. Indiana Dep't of State Revenue, 673 N.E.2d 1209 (Ind. Tax Ct. 1996); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the imposition of adjusted gross income tax.

STATEMENT OF FACTS

Taxpayer consists of several life insurance and non-life insurance entities. For the 2004 and 2005 tax years, Taxpayer filed a consolidated Indiana adjusted gross income tax return to report its income from Indiana activities for all of its non-life insurance entities. For these years, Taxpayer also filed an Indiana adjusted gross income tax return for one of its domestic life insurance entities ("Entity A"). Taxpayer had another domestic life re-insurance entity ("Entity B") that was not included on any tax filing in Indiana for the 2004 tax year, but did file an Insurance Premiums Tax return for the 2005 tax year. After an audit, the Indiana Department of Revenue ("Department") issued proposed assessments for additional adjusted gross income tax for the 2004 and 2005 tax years. The Department found that the Taxpayer's Indiana adjusted gross income was not fairly reflected when Entity A's activities were reported separately from Entity B's activities and required a combined filing for Entity A and Entity B. Taxpayer protested the assessment. An administrative hearing was held, and this Letter of Findings results.

I. Adjusted Gross Income Tax—Imposition.

DISCUSSION

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed accurate, and the taxpayer bears the burden of proving that an assessment is incorrect. Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Taxpayer protests the Department's determination that Taxpayer should file a combined Indiana return for Entity A and Entity B as provided under IC § 6-3-2-2(l), (m).

IC § 6-3-2-2, provides, in relevant parts:

...

(l) If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (1) separate accounting;
- (2) for a taxable year beginning before January 1, 2011, the exclusion of any one (1) or more of the factors, except the sales factor;
- (3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's income derived from sources within the state of Indiana; or
- (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

(m) In the case of two (2) or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests, the department shall distribute, apportion, or allocate the income derived from sources within the state of Indiana between and among those organizations, trades, or businesses in order to fairly reflect and report the income derived from sources within the state of Indiana by various taxpayers.

...

(p) Notwithstanding subsections (l) and (m), the department may not require that income, deductions, and credits attributable to a taxpayer and another entity not described in subsection (o)(1) or (o)(2) be reported in a combined income tax return for any taxable year, unless the department is unable to fairly reflect the taxpayer's adjusted gross income for the taxable year through use of other powers granted to the department by subsections (l) and (m).

....

In addition, [45 IAC 3.1-1-62](#), states:

All corporations doing business in more than one state shall use the allocation and apportionment provisions described in Regulations 6-3-2-2(b)-(k) [[45 IAC 3.1-1-37](#)–[45 IAC 3.1-1-61](#)] unless such provisions do not

result in a division of income which fairly represents the taxpayer's income from Indiana sources. In such case the taxpayer must request in writing or the Department may require the use of a more equitable formula for determining Indiana income. However, the Department will depart from use of the standard formula only if the use of such formula works a hardship or injustice upon the taxpayer, results in an arbitrary division of income, or in other respects does not fairly attribute income to this state or other states. It is anticipated that these situations will arise only in limited and unusual circumstances (which ordinarily will be unique and nonrecurring) when the standard apportionment provisions produce incongruous results.

The Department determined that Taxpayer's election to file the two similar and related entities under two different taxing regimes does not fairly reflect Taxpayers' Indiana income. Taxpayer elected for Entity B, the re-insurance entity, which does not have any direct premiums, to file premiums tax resulting in zero insurance premiums tax. Taxpayer elected for Entity A, the insurance company, to file adjusted gross income tax resulting in zero adjusted gross income tax because substantially all of its premiums are ceded to the related re-insurance entity. Thus, in making these elections, Taxpayer found a way to receive over \$16,000,000 in 2004 and over \$34,000,000 in 2005 in premium income from Indiana activities and pay no tax to Indiana. If Taxpayer had made elections for both entities to file the same type of tax on the same return, the distortion would not result and Taxpayer would pay an amount of tax reasonably related to its Indiana activities.

The Department first considered merely reversing the "other income/loss" line item reported for Entity A, which represented Entity A's ceded premiums to Entity B. However, the Department found that the disallowance of this line item without the inclusion of Entity B in the combined return to eliminate all the effects of re-insurance transactions would result in an unreasonably high taxable income figure. Since Entity A's and Entity B's transactions were so intertwined that it was impossible to accurately separate all the insurance/re-insurance activities in order to fairly reflect Indiana adjusted gross income, the Department determined that a combined filing fairly reflected Indiana adjusted gross income.

The Department notes that IC § 6-3-2-2(p) does not require the Department to provide explanations of why other methods do not fairly reflect Indiana income. The requirement is that the Department be unable to fairly reflect Indiana income using other methods before requiring a combined return. The Department provided an explanation in the audit report concerning the interwoven nature of the entities' activities in this case. The Department explained that it was unable to otherwise fairly reflect Taxpayer's Indiana income and required combined filing, as allowed under IC § 6-3-2-2(l). The Department considered combined filing as a last resort, as required by [45 IAC 3.1-1-62](#).

A. Inclusion in Adjusted Gross Income Tax Return.

Taxpayer asserts that while Entity A and Entity B are unitary, Entity B cannot be included in any Indiana adjusted gross income tax return, including a combined return. Taxpayer maintains that Entity B's income is exempt from adjusted gross income tax under IC § 6-3-2-2.8, which precludes Entity B's inclusion in the adjusted gross income tax returns.

IC § 6-3-2-2.8(4) provides:

Notwithstanding any provision of [IC 6-3-1](#) through 6-3-7, there shall be no tax on the adjusted gross income of... [i]nsurance companies subject to tax under [IC 27-1-18-2](#), including a domestic insurance company that elects to be taxed under [IC 27-1-18-2](#).

1. 2004 Tax Year.

For the 2004 tax year, Taxpayer failed to file either an election or a return with the Department of Insurance as required under IC § 27-1-18-2, therefore, the Taxpayer has not elected for Entity B to be taxed under IC § 27-1-18-2. Since only the domestic insurance companies that have made an election to be taxed under IC § 27-1-18-2 are exempt from Indiana adjusted gross income tax, Entity B is subject to Indiana adjusted gross income tax. In fact, IC § 27-1-18-2(a)(4), in relevant part, provides that "[i]n each calendar year with respect to which a domestic company has not elected to be taxed under this section it shall be taxed without regard to this section." Accordingly, for the 2004 tax year, the Department has properly determined that Entity B is subject to adjusted gross income tax and can be included in an Indiana adjusted gross income tax return.

2. 2005 Tax Year.

For the 2005 tax year, Taxpayer was granted permission for Entity B to file a return with the Department of Insurance as found under IC § 27-1-18-2. Therefore, pursuant to IC § 6-3-2-2.8(4), Entity B's adjusted gross income cannot be taxed under IC § 6-3. Thus, Entity B cannot be included in the combined return.

Notwithstanding, when Taxpayer elects to have Entity B, its re-insurance entity, file premiums tax and Entity A, its insurance entity, file adjusted gross income tax, Taxpayer's income derived from Indiana sources is not "fairly reflected." Pursuant to IC § 6-3-2-2(l) and (m), when a taxpayer's income is not fairly reflected, the Department is authorized to employ a reasonable method that results in an equitable distribution, allocation, or apportionment of income to Indiana.

Taxpayer maintains that since there is no statute that directly requires it to file both entities under same type of tax regime, the Department does not have the power to impose those requirements or the power to limit the extent of the exemption. Taxpayer offers no explanation of how this tax avoidance could fairly reflect its income activities in Indiana, but simply asserts that the tax avoidance measures must be allowed because the measures

are not explicitly disallowed in the statute.

However, notwithstanding Taxpayer's argument, the Department does have the statutory authority, pursuant to IC § 6-3-2-2(l) and (m) to fairly reflect the Taxpayer's adjusted gross income. In fact, IC § 6-3-2-2(m) provides, "In the case of two (2) or more... businesses owned or controlled directly or indirectly by the same interest, the department shall distribute, apportion, or allocate the income derived from sources within the state of Indiana between and among those... businesses in order to fairly reflect and report the income derived from sources within the state of Indiana by various taxpayers." Under this statutory authority, the Department found that Taxpayer's election to file the two similar and related-entities under two different taxing regimes does not fairly reflect Taxpayers' Indiana income. Taxpayer elected for the re-insurance entity, which does not have any direct premiums, to file premiums tax resulting in zero insurance premiums tax. Taxpayer elected for the insurance company to file adjusted gross income tax resulting in zero adjusted gross income tax because substantially all of its premiums are ceded to the related re-insurance entity. Thus, in making these elections, Taxpayer found a way to receive over \$34,000,000 of premium income from Indiana activities and pay no tax to Indiana. Meanwhile, if Taxpayer had made elections for both entities to file the same type of tax on the same return, the distortion would not result and Taxpayer would pay an amount of tax reasonably related to its Indiana activities. The Department was fully entitled to conclude that such a significant distortion of Taxpayers' taxable Indiana income did not "fairly reflect" Taxpayers' income derived from sources within the state of Indiana.

While the Department cannot require the inclusion of Entity B, which has made an election to file the premiums tax, the Department can focus on a way to fairly reflect the Indiana income of Entity A, which has elected to file adjusted gross income tax returns. Since Entity A's filing separately from Entity B does not fairly reflect Entity A's Indiana adjusted gross income and a combined filing, which is the fairest reflection, is not allowed for the tax year 2005, an alternative method must be used as provided in IC § 6-3-2-2(m). Therefore, this file will be returned for a supplemental audit for the Department to use one of the remaining alternative methods to result in the fairest reflection of Entity A's Indiana adjusted gross income under these circumstances for the 2005 tax year.

B. Combined Group.

Taxpayer maintains that if the Department requires the combined filing of Entities A and B, its other entities, the non-life insurance entities, should be in the combined filing as well. Taxpayer explains that I.R.C. § 1504(b), which disallows the consolidated filings of insurance and non-insurance companies, is a consolidated return provision that does not apply when the Department requires a combined filing. Taxpayer cites generally to *Cooper Industries v. Indiana Dep't of State Revenue*, 673 N.E.2d 1209 (Ind. Tax Ct. 1996) asserting that consolidated rules never apply to combined filings. Taxpayer, therefore, invites the Department to allow Taxpayer to file as one unitary group creating a "combined income" of insurance and non-insurance adjusted gross income.

However, Taxpayer has failed to explain why this filing method would more fairly reflect Taxpayer's Indiana adjusted gross income. Nonetheless, even if such support had been provided by Taxpayer, the Department would and does now decline the Taxpayer's invitation. While the Department notes that I.R.C. § 1504(b) strengthens the Department's position, the Department's decision to not allow the combination of the insurance and non-insurance companies has other support. IC § 6-3-1-3.5 distinctly defines a corporation's adjusted gross income in subsection (b) differently from a life insurance company's adjusted gross income in subsection (d). Moreover, IC § 6-3-2-2, the statute prescribing the method by which the Indiana adjusted gross income tax is computed, provides a one-factor apportionment method for life insurance companies and a separate three-factor apportionment and allocation method for the other corporations. These statutory differences for life insurance companies and other corporations not only make it impossible to compute a "combined income" for the insurance and non-insurance corporations, but imply that the legislature did not intend for the two types of businesses to be combined. Accordingly, the Department was correct in computing the Taxpayer's adjusted gross income separately for its group of life insurance entities and its group of non-life insurance entities.

FINDING

Taxpayer's protest is respectfully denied.

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